RBI to Restart Operation Twist

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Why in News

The **Reserve Bank Of India (RBI)** has decided to conduct **simultaneous purchase and sale of government securities under Open Market Operations (OMO)** for ₹10,000 crore each on April 27, 2020 considering the current and evolving liquidity and market conditions.

> Such Open Market Operations are known as **'Operation Twist,'** which was used by the RBI in December, 2019 for the first time.

Key Points

- Operation Twist is the RBI's simultaneous **selling of short-term securities and buying of long term securities** through **Open Market Operations (OMO)** in order to **bring down long-term interest rates and bolster short-term rates.**
  - Operation Twist **was first used in 1961 by the US Federal Reserve** (central bank) as a way to strengthen the U.S. dollar and stimulate cash flow into the economy.
- Under this mechanism, **the short-term securities are transitioned into long-term securities.**

- **Impact of Operation Twist:**
  - As the central bank **buys long-term securities (bonds),** their demand rises which in turn **pushes up their prices.**
  - However, the **bond yield comes down** with an increase in prices **(inverse relationship).**
    - Yield is the return an investor gets on his (bond) holding/investment.
  - The interest rate in an economy is determined by yield. If yield is low, interest rates decrease.
  - Thus, lower long-term interest rates mean people can **avail long-term loans** (such as buying houses, cars or financing projects) **at lower rates.**
  - This will lead to a boost in consumption and spending in the economy which in turn will revive the growth.

Government Security

- A G-Sec is a **tradable instrument** issued by the **Central Government or the State Governments.**
- It acknowledges the Government's debt obligation. Such securities are:
  - **Short term securities**
    - They are usually called **treasury bills,** with original **maturities of less than one year-** presently issued in three tenors, namely, 91 day, 182 day and 364 day.
  - **Long term securities**
    - They are usually called **Government bonds or dated securities** with original maturity of **one year or more.**
- In India, the **Central Government issues both treasury bills and bonds or dated securities** while the **State Governments issue only bonds or dated securities,** which are called the State Development Loans (SDLs).
- G-Secs carry practically **no risk of default** and, hence, are called **risk-free gilt-edged instruments.**

Open Market Operations

- Open Market Operations (OMO) is one of the **quantitative** monetary policy tools which is **employed by the central bank of a country to control the money supply in the economy.**
  - Other monetary policy tools are such as repo rate, cash reserve ratio and statutory liquidity ratio, etc.
- OMOs are conducted by the RBI by way of **sale or purchase of government securities (g-secs) to adjust money supply conditions.**
  - RBI carries out the OMO **through commercial banks** and does not directly deal with the public.

- The central bank **sells g-secs to remove liquidity** from the system and **buys back g-secs to infuse liquidity** into the system.

Source: TH